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RUEHQT/AMEMBASSY QUITO 2070
RUEHSG/AMEMBASSY SANTIAGO 3509
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RUCNDT/USMISSION USUN NEW YORK 0190
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TREASURY FOR KLINGENSMITH AND NGRANT

E.O. 12958: DECL: 04/17/2020
TAGS: EFIN ECON PGOV VE
SUBJECT: BOLIVARIAN SPENDING UNSUSTAINABLE BELOW USD
40/BARREL?

REF: A. CARACAS 00905

¶B. CARACAS 00943

Classified By: ECONOMIC COUNSELOR ANDREW N. BOWEN FOR 1.4 (D)

¶1. (C) SUMMARY. Milton Guzman, the Vice President of Research with the Banco de Venezuela Santander Investment Group, said that if the Venezuelan oil basket price dropped to USD 40 per barrel (from the current USD 60.29 per barrel for April 2006), the current levels of BRV central government spending would be unsustainable. With a non-oil deficit (which is the central government deficit assuming no oil revenue) of 18 percent of GDP, Venezuela remains extremely dependent on oil prices (and production levels) to maintain current levels of spending. END SUMMARY.

¶2. (C) For 2006 and 2007, Guzman did not anticipate the BRV will face a deficit, but warned of fiscal vulnerability. According to Guzman, despite impressive growth in BRV non-petroleum income as a percentage of GDP from 9.6 percent (USD 8 billion) in 2003 to 16 percent (USD 21 billion) estimated for 2006 (largely from increased tax collection by the Venezuelan tax authority, SENIAT), the BRV central government non-oil deficit is huge (18 percent of GDP or around USD 24 billion). (Note: The non-oil deficit equals total central government non-oil revenue minus central government expenditures. This calculation measures the BRV's ability to cover expenditures without any oil income. End Note.) This simple measure quantifies the BRV's dependence on oil revenue, and consequently oil prices.

¶3. (C) According to Guzman's sensitivity analysis considering various oil price scenarios (see paragraph 4), the current levels of BRV central government spending are unsustainable if the Venezuelan oil basket price drops below USD 40 per barrel. If the oil price drops, the BRV would have to borrow more to maintain current spending levels, cover the deficit, and pay debt amortization. Guzman's basic assumptions for 2006 are: BRV central government expenditures of 34.2 percent of GDP (approximately USD 46 billion), an average annual oil price of USD 47.3 per barrel (as compared to USD 60.29 per barrel in April 2006), nominal GDP of USD 135.1 billion, and oil production level of 2.7 million barrels per day. (Note: A number of private sector contacts

believe that Venezuelan crude production has recently dropped to 2.3-2.6 million barrels per day (reftel A). End Note.) As of March 2006, the BRV 2006 authorized central government budget expenditures were USD 46.5 billion, which includes the original annual budget of USD 40.5 billion and additional credits of USD 6 billion for infrastructure and transfers to the states. This does not include expected BRV off-budget spending, which could approach USD 10 billion.

¶4. (SBU) The table below shows the sensitivity analysis based on various oil price scenarios for 2006.

GOVERNMENT FISCAL BALANCE AND FINANCING NEEDS
SENSITIVITY ANALYSIS FOR 2006

VENEZUELAN OIL BASKET AVERAGE (USD/Barrel)	25	30	35	40	47.3 (1)	50
TOTAL REVENUE (AS % OF GDP)	26.1	28.3	30.5	33.0	36.9	38.4
TOTAL EXPENDITURES (AS % OF GDP)	32.4	32.5	33.0	33.1	34.2	34.6
FISCAL BALANCE (AS % OF GDP)	-6.4	-4.2	-2.5	-0.1	2.7	3.8

(1) 2006 Estimate.

Source: Santander Investment Group.

¶5. (C) Since completing this sensitivity analysis in March 2006, Santander Investment has lowered its April 2006

estimate for oil production from 2.7 million to 2.65 million barrels per day. Santander anticipates lower production due to lower investment by both private companies and PDVSA. Santander also has raised its estimate for BRV central government spending from 34.2 to 36.5 percent of GDP. Santander maintains that the BRV fiscal situation is still manageable given continued high oil prices and BRV funds (read: off-budget funds), e.g. the National Development Fund (FONDEN) and the Special Economic Development Fund (FONDESPA) (reftel B).

¶6. (C) Comment: We believe that the BRV may have amassed roughly USD 33.7 billion outside the formal budget process held at the National Development Fund (FONDEN), PDVSA, the Social Economic Development Bank (BANDES), and the Bank of the Treasury to address social and infrastructure needs, pay for state entity expenses (e.g. PDVSA), and serve as a cushion in case of contingencies. Because of the lack of transparency in BRV financial accounting, the BRV can most certainly access these funds with speed and discretion. End Comment.

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